

**Internal Revenue Service**  
Appeals Office

401 W. Peachtree St. NW  
Atlanta, GA 30308

Release Number: **201335027**

Release Date: 8/30/2013

Date: May 3, 2012

**Department of the Treasury**

**Person to Contact:**

**Employee ID Number:**

Tel:

Fax:

**Refer Reply to:**

**In Re:**

**Form Required to be Filed:**

**EIN:**

**Tax Period(s) Ended:**

**UIL:**

0501 .03-00

**Certified Mail**

Dear \_\_\_\_\_

This is a final adverse determination regarding your exempt status under section 501(c)(3) of the Internal Revenue Code (IRC). It is determined that you do not qualify as exempt from Federal income tax under IRC Section 501(c)(3) effective January 1, 2004.

Our adverse determination was made for the following reason(s):

Based upon examination of your records, it has been determined that you do not meet the requirements of an organization described under section 501(c)(3). You have not operated exclusively for charitable, educational or any other exempt purposes. You did not engage primarily in activities that accomplish one or more of the exempt purposes specified in section 501(c)(3).

Contributions to your organization are not deductible under section 170 of the Code.

You are required to file Forms 1120, U.S. Corporation Income Tax Return, for tax periods stated in the heading of this letter and all tax years thereafter. File your return with appropriate Internal Revenue Service Center per the instructions of the return. For further instructions, forms, and information please visit [www.irs.gov](http://www.irs.gov).

If you were a private foundation as of the effective date of revocation, you are considered to be a taxable private foundation until you terminate your private foundation status under section 507m of the Code. In addition to your income tax return, you must also continue to file Form 990-PF by the 15<sup>th</sup> Day of the fifth month after the end of your annual accounting period.

Processing of income tax returns and assessments of any taxes due will not be delayed should a petition for declaratory judgment be filed under section 7428 of the Code.

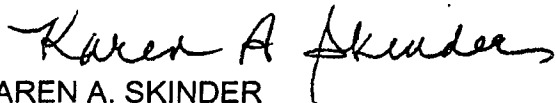
If you decide to contest this determination, you may file an action for declaratory judgment provisions of section 7428 of the Code in one of the following venues: 1) United States Tax Court, 2) the United States Court of Federal Claims, or 3) the United States District Court of the United States for the District of Columbia. A petition or complaint in one of these three courts must be filed within 90 days from the date this determination letter was mailed to you. Please contact the clerk of the appropriate court for rules for filing petitions for declaratory judgment. To secure a petition form from the United States Tax Court, write to the United States Tax Court, 400 Second Street, N.W., Washington, D.C. 20217. See also Publication 892.

We will notify the appropriate State officials of this action, as required by Code section 6104(c). You should contact your state officials if you have any questions about how this determination may affect your state responsibilities and requirements.

You also have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures such as the formal appeals process. The Taxpayer Advocate is not able to reverse legally correct tax determinations, nor extend the time fixed by law that you have to file a petition in the U.S. Tax Court. The Taxpayer Advocate can however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. If you want Taxpayer Advocate assistance, please contact the Taxpayer Advocate for the IRS office that issued this letter. You may call toll-free, 1-877-777-4778, for the Taxpayer Advocate or visit [www.irs.gov/advocate](http://www.irs.gov/advocate) for more information.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

  
KAREN A. SKINDER  
APPEALS TEAM MANAGER

Enclosure: Publication 892

EXPLANATIONS OF ITEMS

Schedule number or exhibit

1

Name of taxpayer

Year/Period ended

ORG formerly ORG-1 - EIN EIN

12/31/20XX; 20XX, 20XX

LEGEND

ORG - Organization name      ORG-1 - 1<sup>ST</sup> ORGANIZATION NAME      ORG-2 - 2<sup>ND</sup> ORGANIZATION NAME      ORG-3 = 3<sup>RD</sup> ORGANIZATION NAME      ORG-4 = 4<sup>TH</sup> ORGANIZATION NAME  
ORGANIZATION NAME      ORG-5 = 5<sup>TH</sup> ORGANIZATION NAME      XX - Date      State - state      DIR-1 through DIR-3 - 1<sup>st</sup>, 2<sup>nd</sup>, & 3<sup>rd</sup> DIR      Vice President - vice president      Vice President-1 = 2<sup>nd</sup> Vice President      CO-1, CO-2 & CO-3 = 1<sup>ST</sup>, 2<sup>ND</sup> & 3<sup>RD</sup> COMPANIES      RA-1 THROUGH RA-10 = 1<sup>ST</sup> THROUGH 10<sup>TH</sup> RA

ISSUES

1. Whether ORG (previously ORG-1 and ORG-2) (hereinafter referred to as ORG) operated exclusively for exempt purposes as described within IRC section 501(c)(3):
  - a. Whether ORG engaged primarily in activities which accomplish an exempt purpose?
  - b. Whether more than an insubstantial part of ORG activities were in furtherance of non-exempt purposes?
  - c. Whether ORG was operated for the purpose of serving private rather than public interests?

BACKGROUND

An examination of ORG (as it is now known) was conducted by the Secretary's representative for the taxable periods ending December 31, 20XX, 20XX, and 20XX, respectively.

ORG-3. (the organization's original name) was incorporated 5/18/19XX.

The purpose as stated in the articles of incorporation were:

The corporation is organized exclusively for charitable, religious, educational and scientific purposes, including, for such purposes, the making of distributions to organizations that qualify as exempt organizations under Section 501 (c)(3) of the Internal Revenue Code of 1986 (or the corresponding of any future United States Internal Revenue law). The specific purpose for which the corporation is formed are counseling and fostering of consumer education on family money management, budgeting services and the use of credit. Education concerning debt management. To carry on a legal non-profit under authority of Sections 1702.01 through 1702.99 State Revised Code. Organized and operating exclusively for charitable purposes, including for such purposes as described above.

The Regulations of ORG-3 listed the members of the corporation as DIR-1 and DIR-2, and stated that the Board of Trustees of the corporation shall be three or such greater numbers as shall be fixed from time to time.

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The name of the corporation was changed to ORG-4 and this change was filed with the State of State on May 2, 19XX, and signed by DIR-1 and DIR-2.

In a letter from Internal Revenue Service dated 5/17/19XX, ORG-4 received exemption from Federal Income Tax as an organization described in section 501 (c)(3), and was determined to be an organization described in sections 509(a)(1) and 170(b)(1)(A)(vi).

An amendment to the articles was filed with the State Secretary of State on 3/6/20XX, (signed by DIR-1 and DIR-2), and changed the name of the corporation to ORG-2 and the purpose of the corporation was changed to:

Counseling and fostering of consumer education on family money management, budgeting services and the use of credit. Education concerning debt management. To carry on a legal non-profit organization under authority of Section 1702.01 Through 1702.99 State Revised Code. Organized and operating exclusively for charitable purposes, including for such purposes described above.

On 6/22/20XX, an amendment was filed with the State of State which again changed the name of the organization to ORG-5 and changed the purposes of the corporation to "Non profit credit counseling for individuals". (This was signed by DIR-3 and DIR-1).

On 9/22/20XX, an amendment was filed with the State of State which changed the name of the organization to ORG-1 The purpose did not change. (This was signed by DIR-3).

On 12/8/20XX, an amendment was filed with the State of State which changed the name of the organization to ORG, and changed the purpose to:

To provide debt management assistance to all consumers as well as promote credit education through budgeting tools, educational workshops and credit Counseling services. (signed by DIR-3)

#### Officers and Directors of the Organization

The following individuals were listed as officers, directors, trustees and key employees on the Form 990 (no other individuals were listed).

DIR-1, President, 20XX.  
DIR-2, Treasurer, 20XX  
DIR-3, Vice President, 20XX  
President, 20XX, 20XX, 20XX, 20XX

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Vice President, Vice President, 20XX, 20XX  
Vice President-1, Vice President, 20XX and 20XX

Form 990, Return of Organization Exempt From Income Tax, for the years 20XX, 20XX and 20XX, were all signed by DIR-3.

### Related Organizations

DIR-3 is also President of CO-1, a State non-profit Corporation, which has offices in State and State. DIR-3 moved to State in the fall of 20XX. His wife, Vice President, is also in State. Some of the expenses for ORG were paid by CO-1 and they share some internet sites. Also, some ORG callers are referred to the State office of CO-1.

### **ACTIVITIES AND FUNDING**

#### Debt Management Program (also known as DMP)

A DMP is a plan whereby a client can consolidate their payments to creditors by making one monthly payment to a company and then the various payments to creditors are made for them by this company. The DMP program generally is spread out over a 3-5 year period. Only unsecured debts can be included in a DMP. Most of the debts handled in a DMP are credit card debts, but other unsecured debts can also be included such as medical expenses.

Some restrictions concerning the DMP are set up by the creditors, with the largest creditors making the most demands. When a client enters into a DMP, a "proposal" is sent to each of their creditors and the DMP is not complete until the creditors approve the DMP as set up. Sometimes the amount of payment or some other adjustment is required by the creditors.

Some creditors require that all unsecured debt of a client be included in the DMP in order to be approved. Therefore, in these situations, the client cannot negotiate one on one with one of their creditors to set up a pay plan separate from the DMP. Some creditors will actually pull a credit report to determine that all unsecured debt has been included in the DMP. Most creditors require that the client stop using any credit cards while they are on the DMP program.

Most of the creditors pay a collection fee which is commonly known as "fair share contribution". This fair share is paid to ORG in two ways. Either the fair share is deducted from the client's monthly payment before it is disbursed to the creditor, or the creditor sends a check directly to ORG. This payment is determined by the individual creditors and is usually a percentage of what is collected. Although reported on Form 990 as a charitable contribution, these fees are not charitable contribution because services are provided and the fee is usually based on a percentage of what is collected.

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The benefits of a DMP, should a client qualify, is that the interest rates charged the client could be lower than what they are paying currently and, many times the over limit and late fees will be dropped from the client's account after they have been on the DMP for 90 days.

There is no charge for submitting the financial information to one of ORG's employees to determine if the client qualifies for the DMP. If the client enters into the DMP, there is a one time set-up fee which is generally \$ and is paid first by the client. There is also a monthly processing fee which is included in each monthly payment.

ORG monthly processing fees are not based on the income level of the clients, but are based on the maximum charges allowed by the states in which they operate.

ORG does not operate in every state. In 20XX, ORG did not sell debt management programs to clients in State, State, State, State, State, State, State, State and State. Clients in some of these states were referred to CO-1 (their related organization in State/State).

ORG state that client contact is usually by phone ( %) or internet ( %). Only % is conducted face to face because most of their clients are out of state.

**Funding**

Sources of income are from creditors (known as fair share), DMP set up charges, DMP monthly processing fees, miscellaneous DMP fees (insufficient funds, cancellation or change in DMP, etc.), and interest. ORG stated that they received a grant from CO-1 of \$ in June 20XX.

Although requested, no documentation was provided and this grant was not reported on Form 990 for the year 20XX.

For the 3 years under audit, all sources of funding (except for interest) were incorrectly reported on Form 990, line 1a, as contributions, gifts, grants as direct public support. Instructions for completion of Form 990 include instructions for types of receipts and completion of Line 1. The instructions state that only those payments received, for which the payer (donor) does not receive retail value from the recipient should be reported as donations. In general, do not report as contributions any payments for a service, facility or product that primarily give some economic or physical benefit to the payer... (See Instructions for Line 1, In General).

**Internet Sites**

Clients hear about ORG through their web sites, yellow page ads, google ads, and through friends and family.

Many clients hear about ORG through their two main internet sites, website or website. (the later started late in 20XX). There are also multiple sites (10, according to RA-1), including website.

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which are designed to transfer clients back to one of their two main web addresses. Research into the “ ” web site revealed that in 20XX, there were 5 pages (or tabs) as follows:

“ ”, “ ”, “ ”, “ ”, and “ ”.

The site marketed ORG's debt management plan. The free consultation page invited the client to apply online for their debt management plan and provided a form to complete which included client name, their phone number, creditor names, interest, payment, etc. Household expenses were not included. For the years 20XX, 20XX and through August 20XX there was little change in the site. Exhibit A contains a sample of the web site at February 20XX.

In September 20XX, an Education tab was added and provided a list of articles listed by name. The client selected (or clicked) on one of the articles to read it. However, the main thrust of the web cite continued to be the advertisement of the DMP and offered a “Free evaluation in 15 minutes or less”. The “Home” page and “about us” page had several places where the reader could “click” and would be taken directly to the web application form. See Exhibit B.

The web site website began in late 20XX. Copies of this web site at January 24, 20XX, are attached. It did not contain any educational material and was similar to the other web site. See Exhibit C.

### **Advertising and Marketing Expenses**

In addition to the internet sites, ORG advertises in the Yellow Pages and also had google ads. The Secretary's representative requested copies of advertising on IDR #8 from all sources used. Samples of ads placed in the local newspaper under employment ads were provided. No copies of google ads were provided. Nor were any sample placements in the yellow pages provided.

The single largest expense for the organization, other than salaries in 20XX was advertising, which amounted to \$ (% of non payroll expense).

After DIR-1 and Vice President moved to State in 20XX, some of the advertising for ORG was then paid by the related organization in State, CO-1. This included the Google ads, maintenance of the internet site, etc.

Some of the payroll can also be attributed to marketing expenses. When asked what duties he performs for ORG, DIR-3 explained that he pays the bills and does the advertising. He went on to explain that Vice President did not do counseling in the years under audit; her duties entailed getting the bills ready for payment, marketing, and special projects. (Interview conducted 3/28/20XX).

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IDR #14 requested a log of duties for DIR-1 and Vice President for the years under audit and a break out by percentage of time spent on each category or duty. This IDR also requested a job description and number of hours spent at any other company. The response stated that no logs or percentages could or should ever be completed.

DIR-3 was paid \$ in 20XX, \$, plus \$ in employee benefit plans in 20XX, and \$ plus \$ in employee benefit plans in 20XX.<sup>1</sup> Vice President

DIR-3 was paid \$ in 20XX, \$ plus \$ in employee benefit plans in 20XX and \$ plus \$ in employee benefit plans in 20XX.

### DMP Client Setup

Some clients call directly to the ORG “800” number. Other clients submit web applications. The web application asks for unsecured creditor information only. RA-2 explained on 6/19/XX, that she gets a pop up notice to let her know when a web application is received. She clicks on it and prints it. RA-3 prints all web applications — unless she is on break. The client is called ASAP to set an appointment and explain the program. Some web applications provide only a name and phone number, some also provide the creditor information.

If the client can’t be reached right away, they go on a daily call log. Once reached, most clients are set up with an appointment (phone), but sometimes they can talk immediately to the employee assigned to take these calls. Many times there are several phone conversations during the process.

The software program walks the ORG employee through the process. The caller is asked to provide ORG with their income and creditor information first (name of creditor, balance, percentage interest charged, etc). This is referred to as an “education review” or “debt review” by the ORG staff.

The various creditor requirements are already input into the software, so the ORG employee uses this information to determine what minimum payment each creditor requires and also what the interest rate will be for that creditor on the DMP. It is noted that the household expenses (rent, mortgage, utilities, groceries, etc). are not always obtained at this juncture. This information is sometimes obtained when the client returns the “client financial statement”, which is sent out to the callers if they agree to sign up.

<sup>1</sup> DIR-3 was also paid \$ by CO-1 in 20XX and listed as President on the Form 990 filed by that organization. He was also paid \$ in 20XX by CO-2 (response to IDR #16 received 9/11/20XX) Note: ORG’s Form 990, line 74c, stated that no officers, directors, trustees, or key employees listed on Form 990 receive compensation from any other organizations, whether tax exempt or taxable.



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If the caller does not qualify (currently unemployed) or is not interested in the program, they are not given a client number and their information goes into the "web application file" and is filed by year and by the last name. (Information provided by RA-2, June 19, 20XX. No file folder is set up for a caller until they sign up on a DMP.

If the caller qualifies and is interested in the program, they can begin the set up of the DMP by giving permission over the phone and the set up fee of \$ will be deducted on the agreed date. They are given a client number and the web application goes into their file ( software program).

The "initial package" is then sent out to qualifying callers. This paperwork is described below and the signed documents must be returned before the first scheduled monthly DMP deduction.

A sample initial packet for 20XX was provided. It contained the following items.

1. Welcome letter with checklist of items that need to be returned
2. Creditor Information Release Form (requiring client signature)
3. The debt management agreement (requiring client signature)
4. Authorization for direct debit deduction (from client's checking account)
5. Client Financial Statement (blank) — client provides income, monthly household expenses, and loan payments (secured loans, etc.), with the bottom line revealing what is available for DMP.
6. New client interview checklist (requiring client signature)

Item #3 above, the debt management agreement, states that the monthly DMP fee is a "charitable contribution".

RA-3, ORG employee, stated on 3/29/20XX that she will not send a copy of the budget analysis or brochure to a client unless the client requests it".

Then there are follow-up calls if the client fails to return the required documents.

Once the documents are received, the proposals go out to various creditors. Calls are made to the creditors and back to the clients to agree to any adjustments required by the creditors. Once everyone is in agreement, the DMP program begins for the clients and on a monthly (or every two week) basis the client remits a payment (usually pulled electronically from their account) and then payments of various clients are "bundled" together and sent out to the creditors (usually electronically).

Additional information is sent out at 30 days and 90 days. The clients also receive a monthly statement which they are asked to review and then report any discrepancies to ORG.

And, finally, if any client fails to make their monthly payment while on the DMP program, there

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are follow-up calls.

### Scripts

This is a training document used for new employees. It contains sample client calls and recommended responses. The 20XX script contained the following passages.

- The object of the information call is to first determine who the client is, where they are from, and how they heard about us. Second, we need to determine if the service we offer is what they are looking for. Finally, we need to get that individual on the phone with a counselor as quickly as possible (page 3).
- Let me start by telling you a little about the services we offer. We are a non-profit organization focused on helping you get out of debt. If you are struggling with paying your debts, behind on payments, or possibly considering bankruptcy...our debt management program may work for you. (page 4)
- Page 5 starts with: Are you currently employed or have a monthly source of income? If yes, continue with the script. If no., I am sorry, but at this time we are unable to assist you with debt management plan. You must have a consistent monthly source of income. I would be happy to answer any additional questions you may have. (refer to page 18).

Page 18 - 21 of the script provide answers to the following questions.

- What types of fees do you charge?
- I thought you were a non-profit organization, why do you charge fees?
- Will my credit cards be closed or cancelled?
- Will I be able to re-open my credit card account(s) once I have paid off my balance?
- Do I have to have a minimum amount of debt to be enrolled?
- Where are you located/how long have you been in business?
- If I enroll, how long will it take for me to see reduced interest rates and eliminate late fees and over-the-limit charges?
- I have a Master Card or Visa (etc.) what type of interest reduction can you offer me on that card...or do you stop the interest?
- How long will it take to complete the program?
- How will this affect my credit rating?

### Observed Client Sessions.

There are usually a series of several phone calls made in order to set up a client on the DMP program. Rarely does a client come into the office for a face to face consultation. When the client calls the "800" number for ORG they are presented with option one, which is "new clients", and option two which is "existing clients".

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Client calls were observed on several days. The Secretary's representative requested to observe over several days in advance to get a good representation and so appointments could be scheduled during those times. Some days were fruitful; other days little or no calls came in. The complete write-up of these calls is attached as Exhibit D.

Some sample initial calls (not web site applications):

Incoming call to RA-4, ORG employee, 6/18/20XX. NEW CALLER  
RA-4 introduced herself.

Client: Can you tell me about your services you offer.

RA-4: Yes, we offer a plan that includes creditor payments consolidated into one payment and which may include reduced interest rates and remove over or late fees.

In another initial call, the program was explained as follows by RA-2 on 6/18/20XX. RA-3 answered the phone and identified herself and asked the caller if they were familiar with their program?

No

We are able to enroll your unsecured debt such as credit cards, medical debt unsecured loans, collection debt. We work with the creditors to reduce or eliminate your interest. If you're late in payments we work with the creditors to get the accounts brought current and possibly stop or reduce your late and over the limit fees. (RA-3 repeated this for me after the call was finished so it was complete).

The calls observed ranged from 1 minute to 35 minutes. The majority of the calls were 5 minutes or less. The ORG employees do not have to follow the script word for word per Vice President-1 3/21/20XX. This was confirmed on the calls observed; the explanations to the clients were much briefer than the scripts. The following items were noted during the calls. (The complete detail of the clients calls are included in Exhibit D attached).

- In one call only the clients income and creditor information is obtained. The client is told they qualify for the DMP program (however, no information on household expenses was obtained). They are then told a packet will be sent which will include a financial statement which needs to be completed in order to get income and household expenses. See Exhibit E, 3-21 -07, Caller #7.

- In another call the caller is told that there is a one time set up fee of \$; When I give you your monthly payment it will include a monthly contribution that is tax deductible (emphasis added).

The client responded: There's a monthly fee?

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The response: That will include a monthly tax deductible contribution (emphasis added). Do either one of you itemize on your taxes? See Exhibit E, 6-1 8-20XX, Caller #1.

• Caller #5 on 3-21 -XX, is a repeat customer. They are signed up on the DMP, but not given any kind of budget review or other counseling on their continuing problems with debt.

### Customer Complaints

In May 20XX, a customer complained to Better Business Bureau that when they called ORG (known as ORG-2 at this time) to cancel their DMP program they were told they would be charged \$. The client put a stop payment on the \$ with their bank; however ORG withdrew a smaller amount of \$ (to get around the \$ stop payment). This procedure is explained to a client in call #8 on 8/20/XX, see Exhibit D attached.

The customer also complained that they had been told their "contributions" were tax deductible and since a I O4OEZ was filed, they could not take this deduction and requested to be repaid the \$ contributions which they had paid (\$ per month).

ORG redeposited the \$ into the client's account and stated that the client had used the "wrong tax form" and that is why they couldn't take the tax deduction; they would not refund the \$ because they provided a service.

### Employee Background and Training

Most of the employees were interviewed to learn about their backgrounds, procedures, etc.

DIR-3, who is President, has lived in State since late 20XX. He communicates with the office manager by phone daily. He has been back to State 3 or 4 times with the last time being mid 20XX. DIR-1 handles licensing, marketing, and checks paid for general operations (operating account). Per DIR-2 on 3/23/20XX, DIR-1 is not tied into the (DMP) computer system.

Vice President, was vice-president in 20XX and 20XX, and worked at home (State since late 20XX). DIR-1 explained 3/28/XX, that in 20XX, 20XX, and 20XX, she handled grant projects, marketing, special projects, and would get the bills ready for payment for DIR-1

Vice President-1 has an associate's degree in business. She took new client calls in 20XX, as well as performed other duties and continues to take new client calls when the principal employees are busy. She also takes existing client calls. She became the office supervisor in 20XX and also became an officer of ORG in 20XX, and now handles the payroll.

Vice President-1 had hands on training and observation for 45 to 60 days when she came to

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ORG. There was no training manual. She believes there was some sort of script (which is a mock conversation with a client beginning with an explanation of the DMP and possible questions and answers). Also, there were examples of the material given to new clients, etc.

RA-1, is the supervisor of the employees who receive new client calls as well as existing client calls. She has a high school education and previous experience as the manager of a cash advance store and district supervisor at the CO-3. She also still takes new client calls and existing client calls, if needed.

RA-1 is also responsible for the education arm of ORG and also prints out various reports for the office including appointment lists, follow-up lists, planner reports, etc.

New client calls were handled by multiple people in the years 20XX, 20XX, and 20XX. RA-3, RA-2 (20XX and hired again when RA-5 left) and many others were hired for this job (described as counselor) and have since left the organization.

RA-5 has an associate degree in business and worked previously in a similar position at another credit counseling organization. RA-3 has a high school education and worked previously in a similar position for another credit counseling organization.

Both RA-5 and RA-3 explained that they were trained by RA-1 on the computer and began by sitting with RA-1 on the phones and listening to her and then they took calls and RA-1 observed. The only training material in house was the script.

Customer Service calls (existing clients and creditor calls) are taken by RA-4 and two part time employees.

Data entry (of the DMP's) and operations of the electronic transfers to and from the trust bank account is done by \_\_\_\_\_, whose educational background is at State State University in electrical/computer. A part time employee enters the new clients into the system to schedule their payments.

RA-6 was office manager, but is now a program specialist and works out of her home in State. We were told that RA-7 sometimes takes callers in the evening. Both are tied into the software system.

IT software is maintained by DIR-2, who was an officer in 20XX, 20XX. His educational background in electrical engineering/computers is from State State University.

And, finally there is a part time mail clerk, RA-8, and a receptionist, RA-9.

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### Employee Certification

To be certified through AFCPE (Association of Financial Counseling and Planning Education) as a certified financial counselor a person reads 3 books in conjunction with a study guide. Then they are tested for certification. Once certified, they must take a workshop every two years. Individuals are eligible to begin the study course after they have worked 1000 hours in admissible financial counseling.

RA-1 received certification from AFCPE in October 20XX. Vice President-1 and DIR-3 were certified in 20XX and RA-3 and RA-4 were certified in the Fall of 20XX. RA-5 worked for a year before becoming certified. RA-3 and the other individuals who took new client calls during the years of the audit were not certified.

### Education and Outreach

A questionnaire (Form 13769), signed by DIR-3 on March 25, 20XX, was completed and returned to IRS. It indicated that the organization offers seminars taught by qualified instructors which are advertised to the public. As part of the audit process, the Secretary's representative requested documentation of these seminars. None was provided.

On 3/23/XX, RA-1 explained that she is in charge of the education program for ORG. ORG began offering a "tele course" to students in June 20XX. She stated there is no test. A certificate of completion is given. When asked about documentation, RA-1 explained that one person has completed the course.

RA-1 also explained that ORG scheduled their first outreach seminar at the local public library in December 20XX, conducted by her. It was advertised in the local paper and a notice was put up on the library's bulletin board. No one signed up for the seminar, however, some people who were in the library stopped in and took some brochures. There was no sign in sheet provided as documentation for this seminar.

RA-1 also explained that brochures or a budget book could be sent out to clients if they request them. When asked how the clients would know to request anything, RA-1 explained that if the counselor determined it is something that would help them, they might recommend it to them.

RA-8, the mail clerk who had started with ORG in February 20XX, stated on May 2, 20XX, that the postage is 63 cents when a budget worksheet is sent out. She then stated that she had sent 2 or 3 since she had started.

is a publication, which ORG states that they provide to their clients. On IDR #11, issued 3/26/XX, the Secretary's representative requested the name of the author and documentation as to the number of copies ordered, printed, and mailed during 20XX.

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The ORG response: DIR-1 and Vice President are the authors and the number of copies ordered, printed, and mailed during 20XX is unavailable.

ORG (or ORG-2 as it was previously known) provided copies of newsletters which they state were included with their DMP clients monthly statements from February 20XX to May 20XX. It contained educational information about debts, grocery shopping, IRS tax tips, etc. It also contained information about the DMP program. The February 20XX letter contained the following statement:

The documentation provided for their education program included newsletters, videos, etc. which ORG state they used for educational programs later in 20XX and beyond. Our audit did not confirm or deny that these were offered to the general public as they were beyond the years of our audit.

Statistics

Sales and call statistics are shared with the ORG employees on a weekly basis, which also includes month to date figures, in a report known as "Planner Statistics". The call results are broken down by employee and then by total. As an example, the Planner Statistics for 10/29/XX, reported the following month to date totals.

Total # of calls taken:

Total # of calls made:

Total # of Info calls:

Debt Reviews:

Signs (client agreed to DMP)

Startups paid

Debt review vs info calls % %

Signs vs reviews % %

Startups pd vs reviews % %

Startups vs signs % %

Cancellations (includes who completed the program)

Total active (clients)

Monthly Income \$

There is also a call tracking report listing each employee, the number of calls taken, the number of calls made, and call duration.

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## LAW

### IRC 501(c)(3)

Section 501(a) of the Internal Revenue Code provides that an organization described in section 501(c)(3) is exempt from income tax. Section 501(c)(3) of the Code exempts from federal income tax corporations organized and operated exclusively for charitable, educational, and other purposes, provided that no part of the net earnings inure to the benefit of any private shareholder or individual. The term charitable includes relief of the poor and distressed. Section 1.501(c)(3)-i(d)(2), Income Tax Regulations.

Section 1.501(c)(3)-1(a) of the Treasury Regulations provides for organizational and operational tests. (1) In order to be exempt as an organization described in section 501(c)(3), an organization must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational test or the operational test, it is not exempt. (2) The term “exempt purpose or purposes”, as used in this section, means any purpose or purposes specified in section 501(c)(3), as defined and elaborated in paragraph (d) of this section.”

Section 1.501(c)(3)-1(c)(1) of the Treasury Regulations provides that an organization will be regarded as “operated exclusively” for one or more exempt purposes only if it engages primarily in activities that accomplish one or more of such exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

The term educational includes (a) instruction or training of the individual for the purpose of improving or developing his capabilities and (b) instruction of the public on subjects useful to the individual and beneficial to the community. Treas. Reg. § 1.501(c)(3)-1(d)(3). In other words, the two components of education are public education and individual training.

Educational purposes include instruction or training of the individual for the purpose of improving or developing his capabilities and instruction of the public on useful and beneficial subjects. Treas. Reg. § 1.501(c)(3)-1(d)(3).

In Better Business Bureau of Washington D.C., Inc. v. United States, 326 U.S. 279 (1945), the Supreme Court held that the presence of a single non-exempt purposes, if substantial in nature, will destroy the exemption regardless of the number or importance of truly exempt purposes. The Court found that the trade association had an “underlying commercial motive” that distinguished its educational program from that RA-5d out by a university.

In American Institute for Economic Research v. United States, 302 F. 2d 934 (Ct. Cl. 1962), the



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Court considered the status of an organization that provided analyses of securities and industries and of the economic climate in general. The organization sold subscriptions to various periodicals and services providing advice for purchases of individual securities. Although the court noted that education is a broad concept, and assumed for the sake of argument that the organization had an educational purpose, it held that the organization had a significant non-exempt commercial purpose that was not incidental to the educational purpose and was not entitled to be regarded as exempt.

An organization must establish that it serves a public rather than a private interest and "that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests." Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii).

Prohibited private interests include those of unrelated third parties as well as insiders. Christian Stewardship Assistance, Inc. v. Commissioner, 70 T.C. 1037 (1978); American Campaign Academy v. Commissioner, 92 T.C. 1053 (1989). Private benefits include an "advantage; profit; fruit; privilege; gain; [or] interest." Retired Teachers Legal Fund v. Commissioner, 78 T.C. 280, 286 (1982).

The Service has issued two rulings holding credit counseling organizations to be tax exempt. Rev. Rul. 65-299, 1965-2 C.B. 165, granted exemption to a 501(c)(4) organization whose purpose was to assist families and individuals with financial problems and to help reduce the incidence of personal bankruptcy. Its primary activity appears to have been meeting with people in financial difficulties to "analyze the specific problems involved and counsel on the payment of their debts."

The organization also advised applicants on proration and payment of debts, negotiated with creditors and set up debt repayment plans. It did not restrict its services to the needy. It made no charge for the counseling services, indicating they were separate from the debt repayment arrangements. It made "a nominal charge" for monthly prorating services to cover postage and supplies. For financial support, it relied upon voluntary contributions from local businesses, lending agencies, and labor unions.

Rev. Rul. 69-441, 1969-2 C.B. 115, granted 501(c)(3) status to an organization with two functions: it educated the public on personal money management, using films, speakers, and publications, and provided individual counseling to "low-income individuals and families." As part of its counseling, it established budget plans, i.e., debt management plans, for some of its clients. The debt management services were provided without charge. The organization was supported by contributions primarily from creditors. By virtue of aiding low income people, without charge, as well as providing education to the public, the organization qualified for section 501(c)(3) status.

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In the case of Consumer Credit Counseling Service of State, Inc. v. U.S., 44 A.F.T.R.2d 78-5052 (D.D.C. 1978), the District Court for the District of Columbia held that a credit counseling organization qualified as charitable and educational under section 501 (c)(3). It fulfilled charitable purposes by educating the public on subjects useful to the individual and beneficial to the community. Treas. Reg. § 1.501 (c)(3)-1 (d)(3)(i)(b). For this, it charged no fee. The court found that the counseling programs were also educational and charitable; the debt management and creditor intercession activities were "an integral part" of the agencies' counseling function and thus were charitable and educational. Even if this were not the case, the court viewed the debt management and creditor intercession activities as incidental to the agencies' principal functions, as only approximately 12 percent of the counselors' time was applied to debt management programs and the charge for the service was "nominal." The court also considered the facts that the agency was publicly supported and that it had a board dominated by members of the general public as factors indicating a charitable operation. also. Credit Counseling Centers of State, Inc. v. United States, 79-2 U.S.T.C. 9468 (D.D.C. 1979), in which the facts and legal analysis were virtually identical to those in Consumer Credit Counseling Centers of State, Inc. v. United States, discussed immediately above.

The organizations included in the above decision waived the monthly fees when the payments would cause a financial hardship. The professional counselors employed by the organizations spent about 88 percent of their time in activities such as information dissemination and counseling assistance rather than those connected with the debt management programs. The primary sources of revenue for these organizations were provided by government and private foundation grants, contributions, and assistance from labor agencies and United Way.

Outside the context of credit counseling, individual counseling has, in a number of instances, been held to be a tax-exempt charitable activity. Rev. Rul. 78-99, 1978-1 C.B. 152 (free individual and group counseling of widows); Rev. Rul. 76-205, 1976-1 C.B. 154 (free counseling and English instruction for immigrants); Rev. Rul. 73-569, 1973-2 C.B. 179 (free counseling to pregnant women); Rev. Rul. 70-590, 1970-2 C.B. 116 (clinic to help users of mind-altering drugs); Rev. Rul. 70-640, 1970-2 C.B. 117 (free marriage counseling); Rev. Rul. 68-71, 1968-1 C.B. 249 (career planning education through free vocational counseling and publications sold at a nominal charge). Overwhelmingly, the counseling activities described in these rulings were provided free, and the organizations were supported by contributions from the public.

### Charitable Contributions

The term "charitable contribution", as used in section 170 of the Code, has been held to be synonymous with the word "gift." See Channing v. United States, 4 F. Supp. 33 (D. Mass. 1933), aff'd percuriam, 67 F.2d 986 (1st Cir. 1933), cert. denied, 291 U.S. 686 (1934). A gift for purposes of section 170 is a voluntary transfer of money or property that is made with no

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expectation of procuring a commensurate financial benefit in return for the transfer. H.R. Rep. 1337, 83rd Cong., 2d Sess. A44 (1954); S. Rep. No. 1622, 83rd Cong., 2d Sess. 196 (1954).

### TAXPAYERS POSITION

ORG state they had an educational program during the years under examination.

### GOVERNMENTS POSITION

In order to keep tax exempt status as an organization described in 501 (c), an organization must demonstrate that it is organized and operated in a manner which would continue to classify them as such.

In 20XX, the ORG board consisted of 3 employees who were officers of the organization. In 20XX and 20XX, ORG had only two officers (husband and wife) who formed the board — again employees of the organization. Therefore, during the years of the audit there was no representation on the board that would include a variety of segments of the community such as religious organizations, civic groups, labor unions, business groups or educational institutions. The board members are all officers and employees of the organization, and therefore had a financial interest in the organization.

To determine whether an educational/counseling program existed during the years of the audit, many aspects of the operations of ORG were reviewed to determine their educational/counseling methodology, if any.

The employee's previous employment and educational background were reviewed to determine if any was in the field of education — none was found. The basic training given to employees who took new client calls was centered on the sale of the DMP program.

It is true that after employed for 6 months to a year, some individuals had completed self study in financial counseling, but others had not.

The next step was to see if the practices of ORG provided significant education/counseling in their interaction with their clients. This was done through interviews with the employees, review of the script used, documentation of client records, and observing client calls.

On 8/19/20XX, RA-2 explained that a caller is not given a client number unless they enter the DMP program (see Exhibit D, after caller 6). When we requested to see the budgets of some of the people who had called in to ORG, we were told that two of the callers were not given the choice of completing a budget because "they had secured debt, or the wrong kind of debt".

So it is the practice of ORG to not offer a debt review to callers if they have debt which cannot

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be entered into the DMP program or are unemployed. As a matter of fact, even though the budget could be an educational tool, it is not the practice of ORG to mail the completed budget to anyone -- including their DMP clients. And though we saw complete budgets offered to clients on observed client calls, it was the practice during the years of the audit to mail a financial statement to the clients to complete and mail in and this was only mailed out in the packets of clients who were prequalified on the phone for the DMP program.

Conflicting information has been provided by ORG. On the questionnaire (Form 13769), signed by DIR-3 on March 25, 20XX, it is stated that the organization offers seminars taught by qualified instructors which are advertised to the public. No documentation of any of these seminars was produced. As a matter of fact, when the Secretary's representative talked with RA-1 (in charge of education), she indicated that the first community seminar was conducted in December 20XX, and that the tele-course was begun in June 20XX and only had one certificate of completion through March 20XX.

Were brochures and budget tools distributed to clients? Documentation of this practice is hazy and questionable. The newsletter that went out some months did contain helpful information. But, overall, the distribution of brochures does not allow for interaction to see if people actually read what was provided, or if they even understand what a budget is.

Only the DMP was advertised (except for the one workshop held in December 20XX). The majority of clients learn about ORG through their web site which concentrated on the sale of the DMP through a "15 minute evaluation". How can any counseling/education be offered in 15 minutes when most of this time is spent getting the clients to provide income and unsecured debt information? This 15 minutes evaluation involves obtaining income and creditor information only to determine if they qualify for the DMP program. When first contact is made to the client via a phone call the client is intent only on the DMP because that is what is advertised.

ORG employees did not consistently interview clients about their education level, buying habits, any significant past or anticipated changes in their earnings or expenses or the reason for those changes. The ORG employee never asked how many people were in the household on the calls observed (see client documentation #3 in Exhibit E where the number in the household is entered as "0") There was a lack of significant discussion on the advantages or disadvantages of various options, and recommendations for which options are best suited to meet the client's individual needs, goals or circumstances. The sample client files did not include an "action plan" for the client based on their financial circumstances.

In IDR #14, the Secretary's representative asked for some of the client documentation for the sessions observed. RA-10 had completed a web application (caller #8 on May 18, 20XX), yet in the response to our request for documentation, we were told there was no web application. This caller had no source of income and ORG stated that no documentation was sent or signed. They

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state a budget tracker was mailed; however, there is nothing in the client documentation that states this. (See Exhibit E, client sample #1 documentation).

The documentation for a client who signed up on the DMP is included in Exhibit E also (client sample #2 documentation). There is nothing in the file to indicate what caused the client to have debt problems, there is no action plan for this client, and the response by ORG did not indicate that any educational material was sent to the client.

Most of the daily operations of ORG employees involved the maintenance of the debt management program. This includes setting up the DMP's, correspondence with the creditors, initiating and maintaining the monthly electronic money transfers from the clients to the creditors, maintaining the web sites, and marketing of the DMP.

Follow-up calls to clients who have failed to make a payment are centered on getting the client back on the DMP. The client interaction on call #8 on 3-21-20XX (Exhibit D) did not include asking the client the cause of the missed payment or if their circumstances had changed. There was no counseling observed.

There was no educational program established and running during the years of the audit. And the final and most telling evidence was obtained during the client sessions observed. These calls did not provide evidence of significant counseling/education to the clients. As a matter of fact, the clients were provided with incorrect information when they were told they could itemize their DMP fees as charitable deductions on their tax returns.

One of the first phone calls observed did not complete a full budget, with household expenses included. Yet they were told they qualified for the DMP and an initial packet would be sent to them. Once the secretary's representative mentioned this, the rest of the phone calls included the household expenses. But when one looks at the initial package sent to the clients, it is obvious that the client normally completes the "financial statement" and returns it only when approved for the DMP program.

There was no documentation or observation that ORG operates primarily in activities which accomplish an exempt purpose nor does it operate exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition as specified in Internal Revenue Code 501 (c)(3).

ORG has not demonstrated that it serves a charitable class of individuals. Individuals who have debt problems are not a charitable class of individuals. ORG's fees are not based on the income level of the clients, but based on the maximum allowable under state law. ORG states that % of clients were permitted to waive their monthly service fees, however, this percentage is not significant. In the case of Consumer Credit Counseling Service of State, Inc. v. U.S. 44A.F.T.R.2d 78-5052 (D.D.C. 1978), no fees were charged.

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The main source of funds by ORG is from creditors, which are based on a percentage of the debts collected for them by ORG. The remaining funds are from client fees. There were no grants from United Way or other agencies which were based on the educational/counseling activities of ORG.

All their funds are from services provided, including the funds from creditors. Since services are provided, these funds cannot be classified as gifts or contributions.

ORG activities reveal that they have a significant commercial purpose which serves private rather than public interests. The client calls are essentially sales calls.

### CONCLUSION

In summary, ORG was not operated exclusively for exempt purposes, because it did not engage primarily in activities that accomplish an exempt purpose, more than an insubstantial part of ORG activities are in furtherance of a non-exempt purpose, and ORG was operated for the purpose of serving a private benefit rather than public interests.

Accordingly, it is determined that ORG is not an organization described in section 501 (c)(3), and is not exempt from income tax under section 501, effective January 1, 20XX.